No. 128

In the Supreme Court of the United States

OCTOBER TERM, 1944.

H. LEWIS BROWN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

INDEX

CITATIONS

595004—44——1

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OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 43–61) are reported in 1 T. C. 760. The opinion of the Circuit Court of Appeals (R. 145–150) is reported in 141 F. 2d 307.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 7, 1944 (R. 161). A petition for rehearing was denied on March 6, 1944 (R. 160). The petition for a writ of certiorari was filed on June 5, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

What portion of a fee of $228,608.44 for legal services should be taxed as income of the taxpayer in the calendar year 1937?

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.
>
> The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

STATEMENT

The facts found by the Tax Court (R. 45–53) may be summarized as follows:

The taxpayer, a citizen and resident of New York City, kept his books of account and made his federal income tax return for the year 1937 on the basis of cash receipts and disbursements (R. 45).

On July 2, 1923, the taxpayer, who is a lawyer, and Ambrose H. Burroughs became associated as partners in the practice of law in New York City under the firm name of Burroughs & Brown. Under their agreement, the partners agreed to share equally in the income and expenses of the firm. The agreement also provided that the death of either should not effect a dissolution of the partnership, which was to be continued for six months thereafter, and the estate of such deceased partner should share in the income and expenses of the firm to the same extent that he would have done if he had lived. In case of the dissolution of the firm by the death of one of the partners, the survivor could continue the practice alone or in conjunction with others under the firm name of Burroughs & Brown. (R. 45.)

The original agreement was supplemented on March 19, 1929, by adding the following thereto (R. 46):

> As to work being done by the firm at the time of dissolution, whether pursuant to notice or six months after the death of one of the partners as provided in the contract, the fees and compensation for such work when and as collected shall be apportioned as follows: (1) to the firm such part thereof as will fairly represent the value of the

> service rendered during the existence of the firm, having in view the amount and character of such service as compared with the entire service; and (2) the rest to the partner completing the service after dissolution, or if both partners participate in the work after dissolution, then to each of them in proportion to the fair value of the service rendered by them respectively. This method of division shall be applicable whether the compensation be on a contingent basis or otherwise.

At the time of the formation of the partnership, the members were representing the plaintiff in a patent infringement suit pending in the United States District Court for the District of New Jersey. The decision of the District Court in that case, *Southern Electro-Chem. Co.* v. *E. I. Du Pont de Nemours & Co.*, 9 F. 2d 69, rendered on August 14, 1925, in favor of the defendant was reversed by the Circuit Court of Appeals for the Third Circuit on March 1, 1927 (20 F. 2d 97, rehearing denied May 27, 1927). Under that decision, the Southern Electro-Chemical Company, the client of Burroughs & Brown, became entitled to an accounting for profits and damages growing out of the patent infringement. During the period 1925 to 1929, the firm of Burroughs & Brown received a retainer from the Southern Electro-Chemical Company, principally for services in the litigation and in supervising and giving ad-

vice regarding the company's general affairs. (R. 46–47.)

On January 25, 1929, the firm of Burroughs & Brown entered into a fee agreement under which the firm became entitled to a contingent interest in the ultimate recovery from the litigation. This agreement was with the Alper Chemical Corporation, whose interest in the matter arose from an agreement between it and the Southern Electro-Chemical Company with respect to the conduct of the litigation. (R. 47.) The agreement (R. 47–48) is in the form of a letter addressed to the Alper Chemical Corporation by the firm of Burroughs & Brown, stating that they would take actual charge of the accounting about to commence in the case of *Southern Electro-Chem. Co.* v. *E. I. Du Pont de Nemours & Co., supra,* at the rate of $10,000 per year, and in addition a percentage of any amounts paid by the defendant for infringement.

Burroughs died June 19, 1929, and the City Bank Farmers Trust Company qualified as executor of his estate. Since the death of his partner, with the exception of an eight-month period not here material, the taxpayer has continued the practice of law as sole proprietor under the firm name of Burroughs & Brown. (R. 48.)

As surviving partner, the taxpayer continued the accounting in the patent infringement litigation until September 21, 1937, when a final settle-

ment was reached. The compensation owing under the terms of the contingent fee agreement of January 25, 1929, amounted to $228,068.44. On October 22, 1937, the Southern Electro-Chemical Company delivered to the taxpayer its check for that amount payable to the order of Burroughs & Brown. Under the partnership agreement, the Burroughs estate thereupon became entitled to participation in some part of one-half of that fee, depending upon an allocation thereof between the period of joint interest and the period thereafter. (R. 48.)

Upon receipt of the check for $228,068.44, the taxpayer deposited it in an account with the Chase National Bank which he maintained under the name of Burroughs & Brown and used exclusively for the law office that he was conducting as an individual under that style. Moneys received by him which belonged to others were also deposited in that account. Generally, the monthly balance was never more than $5,000. In addition to the taxpayer, his wife and Clyde D. Sandgren, an employee, each had authority to draw against that account. From October 22, 1937, until December 31, 1937, the lowest balance in the Burroughs & Brown account was $117,930.41. The taxpayer maintained such a high balance during that period because he and the executor of the Burroughs estate had not yet agreed upon the estate's share of the fee. (R. 48–49.)

On October 28, 1937, the taxpayer forwarded to the executor of the Burroughs estate a check drawn on his Burroughs & Brown account in the sum of $7,982.40. The check was accompanied by a letter in which the taxpayer stated his views concerning a division of the fee under which the estate was entitled to three and one-half percent of the total fee paid. (R. 49–50.)

At the time of the receipt of the taxpayer's check for $7,982.40 and his letter of October 28, 1937, the executor had assumed that the estate's share would be very much greater. The check tendered by the taxpayer was received and cashed without prejudice. The taxpayer computed the three and one-half percent of the total fee on a period of joint interest covering the eleven-month period from January 25, 1929, the date of the contingent fee agreement, to December 19, 1929, the end of the six-month period following the death of Burroughs. The executor contended that the fee represented compensation for the whole period of the infringement litigation and that therefore the period of joint interest extended from the inception of the litigation in 1920 until December 19, 1929, or a period of approximately ten years. (R. 50.)

By letter dated March 10, 1938, the executor claimed that the Burroughs estate was entitled to the total sum of $46,052.25 on account of the fee. The difference between the amount claimed

by the estate and the amount previously paid to the estate on October 28, 1937, was withdrawn from the joint bank account of the taxpayer and his wife on March 14, 1938, and deposited in a joint account between the taxpayer and the executor to await a final division after agreement of the parties. (R. 50–51.)

On April 27, 1938, it was agreed that the Burroughs estate was entitled to $14,995.50 on account of the fee based on a joint interest extending from October 15, 1925, to December 19, 1929, a period of approximately 50 months (R. 51).

In his federal income tax return for the calendar year 1937, the taxpayer included as income on account of the fee the sum of $182,016.19, being the full amount of the fee, $228,068.44, less the sum of $46,052.25, the amount first claimed on March 10, 1938, by the Burroughs estate as its share of the fee (R. 52).

The Commissioner treated the total period of joint interest as extending from January 25, 1929, to December 19, 1929, a period of approximately eleven months. On a time basis, he determined that five-elevenths of $14,995.50 was applicable to services rendered prior to the death of Burroughs, and six-elevenths was applicable to services rendered during the period of six months immediately after his death. (R. 51–52.) He included in the taxpayer's income for the calendar year 1937, $221,252.29, being the entire

fee of $228,068.44 less the sum of $6,816.15 allocated by him to the period of joint interest prior to Burrough's death (R. 52).

On February 26, 1940, the taxpayer filed a claim for the refund of $43,450.48 of the taxes paid on the ground that in 1937 the taxpayer was taxable on only one-half of the total fee to which he was unqualifiedly entitled in that year and that he held the other half as trustee for the estate of Burroughs (R. 52–53).

The Tax Court held that, based upon a period of joint interest of 50 months, $13,196.04 of the $14,995.50 actually paid to the Burroughs estate should be allocated to the period of joint interest prior to Burroughs' death, that six-fiftieths or $1,799.46 should be allocated to the period of joint interest after Burroughs' death and that $214,872.40 ($228,068.44 less $13,196.04) was income of the taxpayer in 1937 (R. 60). It was agreed by both parties that the amount of the fee which was paid the estate for the six-month period after Burroughs' death was a capital payment in part for Burroughs' interest in the partnership and was taxable as income of the taxpayer (R. 61). The Circuit Court of Appeals affirmed (R. 145).

ARGUMENT

There is no conflict of decisions and none is pointed out by the taxpayer. Nor is the question one of general interest or of broad application in the administration of the tax laws.

The taxpayer's contention (Pet. 12 (1)) that the Commissioner's determination was upset by the Tax Court is without merit. The opinion of the Tax Court upheld the basic figure of $14,995.50, which the taxpayer agreed with the executor was the estate's share of the total fee, and which was used by the Commissioner in determining the estate's share of the total fee (R. 60). The only change made by the Tax Court was in accord with the taxpayer's alternate contention that the portion payable to the estate as capital, and agreed to be taxable as income to the taxpayer, should be based on a 50-month period of joint interest instead of the 11-month period used by the Commissioner (R. 61).

The decisions below have reached the correct result. The taxpayer filed his income tax returns on the cash basis and in the taxable year 1937 received a total fee of $228,068.44, part of which, under the partnership agreement, was payable to the estate of his deceased partner. In October 1937, he computed the share of the estate at $7,982.40 and sent the estate a check in payment, which was cashed without prejudice as to any further rights of the estate to a larger share. Early in 1938, the estate claimed $46,052.25 *in toto* and in April 1938, the matter was settled on the basis of $14,995.50 as the estate's share of the fee.

The taxpayer claims that his taxable income from the fee in 1937 was $106,050[1] (Pet. 3), representing one-half of the total fee received, less the payment made to the estate in 1937. As the Tax Court and the Circuit Court of Appeals pointed out, there is no sound basis for such a contention. The taxpayer testified (R. 85) that he never expected to pay the estate half of the fee. The estate never claimed half of the fee as its share, and the trust officer testified (R. 95) that he did not expect to get the $46,000 claimed, but only $15,000 or perhaps $12,000. There never was a basis upon which the estate could have claimed half of the fee. Nor did the taxpayer hold half of the fee as trustee for the estate. He recognized no trust and the law did not impose upon him the strict obligations of a trustee. He was not a trustee for tax purposes even if he had been "so denominated" by state law (*Heiner* v. *Mellon*, 304 U. S. 271, 279).[2]

This Court has said that "taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed" (*Corliss* v. *Bowers*, 281 U. S. 376, 378; see also *Griffiths* v. *Commissioner*, 308 U. S. 355,

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[1] The exact figure is $106,051.82.

[2] Under New York law, the taxpayer was not a trustee. (*Gilmore* v. *Ham*, 142 N. Y. 1, 7, 10). The surviving partner does not take over firm assets as a trustee (*Costello* v. *Costello*, 209 N. Y. 252, 259; *Preston* v. *Fitch*, 137 N. Y. 41, 56–57; *Williams* v. *Whedon*, 109 N. Y. 333, 338; *Wilson* v. *International Bank*, 125 App. Div. (N. Y.) 568, 572).

357). In 1937, the taxpayer had full control over the total fee. He deposited the whole fee in the bank account of Burroughs and Brown (R. 77), which was also subject to check by the taxpayer and his wife (R. 83). On October 29, 1937, he withdrew $100,000 from that account (R. 99) and on January 25, 1938, $115,000 was transferred to the personal joint account of taxpayer and his wife (R. 78, 84, 102), leaving a balance in the Burroughs and Brown account of only $3,766.38 (R. 101). It was not until March 14, 1938, that $38,069.85 was withdrawn from the joint bank account of the taxpayer and his wife and deposited in a joint account of the taxpayer and the executor of the estate (R. 51). Throughout all of the year 1937, the funds were under the control of the taxpayer, who claimed all of the total fee, less the $7,982.40 which he admitted was due the estate. See *North American Oil* v. *Burnet*, 286 U. S. 417.

Since the taxpayer was on the cash basis and received the total fee in 1937, his share of the fee, under settled principles of accounting, was taxable to him in 1937, the year of receipt, and in no other year. No part of his share may be taxed as received in the year 1938. The Tax Court has taken the fact established in 1938 by the settlement effected with the estate and thereby determined the taxpayer's share of the fee taxable to him in 1937. It has reached the correct result

to the exact penny. The taxpayer's contention that it should have valued his interest in the fee as of the end of 1937 and ignored subsequent fact to indulge in speculation is without merit. The relation back in the instant case was resorted to only as a means of determining the exact amount of the taxpayer's share of the fee, which was received and had been fully earned in 1937. The result is to tax his share in the year in which he received it, and this result accords with the requirement of the statute that the income be taxed in the year of receipt.

Moreover, there is ample precedent for the Tax Court's determination. In *Freuler* v. *Helvering,* 291 U. S. 35, 38–39, the accounting of a trustee approved in 1928 was held determinative of the taxable income of trust beneficiaries for the year 1921. And the taxable share of a surviving partner was determined by subsequent events in *Pomeroy* v. *Commissioner,* 24 B. T. A. 488, affirmed, 68 F. 2d 411 (App. D. C.), certiorari denied, 292 U. S. 635. Cf. *DeBrabant* v. *Commissioner,* 90 F. 2d 433 (C. C. A. 2d); *Mott* v. *Commissioner,* 139 F. 2d 317, 318 (C. C. A. 6th).

Ithaca Trust Co. v. *United States,* 279 U. S. 151; *Guggenheim* v. *Helvering,* 117 F. 2d 469 (C. C. A. 2d); and *Ray Copper Co.* v. *United States,* 268 U. S. 373, relied upon by the taxpayer (Pet. 16–17), do not control the issue here. The first two cases involved valuation of interests

as of the date of decedent's death as required by the statute for estate tax purposes, and the last case involved the basis (market value of the shares of stock, or the value of corporate assets) of valuing corporate stock for capital stock tax purposes. In such cases, there must be a valuation. The taxpayer's position confuses valuation of an interest for such purposes as distinguished from the determination of the amount of taxable income received in a given year.

The taxpayer contends (Pet. 19–22) that the burden of proof was on the Commissioner to determine the taxpayer's interest in the fee at the end of 1937 and to make an allocation of income between the years 1937 and 1938. The Commissioner determined the income taxable to the taxpayer in 1937 based upon the total fee received, less disbursements made to the estate. He used a period of 11 months' joint interest in adjusting the capital item (R. 53). The Tax Court modified that determination by using a period of 50 months' joint interest according to the agreement of settlement (R. 60–61). Thus, the fundamentals of the Commissioner's determination were sustained, and there was no further burden of proof upon the Commissioner (*Helvering* v. *Gowran,* 302 U. S. 238, 245). The Circuit Court of Appeals said the taxpayer did not meet the necessary burden of proof by showing that the Tax Court's valuation was erroneous merely by arguing that

a precise valuation in 1937 was difficult (R. 150).

The taxpayer asserts (Pet. 12) that the assessment "based exclusively on illegal evidence cannot have warrant in the record." There is no support for such a statement as all of the evidence was presented by the taxpayer (R. 76–113) or was stipulated (R. 114–140).

If the decision in *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231, is applicable, it supports the Government's position rather than that of the taxpayer. Cf. *Dixie Pine Co.* v. *Commissioner,* 320 U. S. 516.

CONCLUSION

The decisions below are obviously correct and there is no warrant for further review by this Court. The petition should be denied.

Respectfully submitted.

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